



# STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date:	02/20/14	Bill No:	<a href="#">Assembly Bill 2009</a>
Tax Program:	Special Taxes and Fees	Author:	Weber
Sponsor:	BOE	Code Sections:	See below
Related Bills:		Effective Date:	01/01/15

## BILL SUMMARY

This Board of Equalization (BOE)-sponsored bill adds Managed Audit Program authority to the following Special Tax and Fee programs: Motor Vehicle Fuel Tax Law, Use Fuel Tax Law, Cigarette and Tobacco Products Tax Law, Alcoholic Beverage Tax Law, Energy Resources Surcharge Law, Emergency Telephone Users Surcharge Law, Hazardous Substances Tax Law, Integrated Waste Management Fee Law, Oil Spill Response, Prevention, and Administration Fees Law, Underground Storage Tank Maintenance Fee Law, Fee Collection Procedures Law, and Diesel Fuel Tax Law.

## ANALYSIS

### CURRENT LAW

Under existing law,<sup>1</sup> the BOE is authorized to examine the books and records of any taxpayer or feepayer (taxpayer) to determine the correct tax or fee (tax) liability. The authority is granted in order to verify the accuracy of any return made, or, if no return is made by the taxpayer, to ascertain and determine the amount required to be paid.

Under existing Sales and Use Tax Law,<sup>2</sup> the BOE is authorized to utilize a Managed Audit Program (MAP) which allows taxpayers to perform audits of their own books and records, with BOE guidance, in order to determine tax deficiencies. In return for performing the managed audit, taxpayers are liable for only one-half of the interest related to an identified deficiency. Taxpayers' participation in the MAP is entirely voluntary.

Managed audits are essentially supervised self-audits. Under the existing MAP, the BOE is authorized to determine which taxpayer accounts are eligible to participate in a MAP and to enter into MAP Participation Agreements with eligible taxpayers. The auditor provides written and oral instructions to enable eligible taxpayers to perform audit verification and prepare working paper schedules necessary to complete certain portions of the audit. Candidates for a managed audit must:

- Have few or no statutory exemptions;

<sup>1</sup>Revenue and Taxation Code Sections 8253 (Motor Vehicle Fuel Tax Law), 9254 (Use Fuel Tax Law), 30454 (Cigarette and Tobacco Products Tax Law), 32453 (Alcoholic Beverage Tax Law), 40174 (Energy Resources Surcharge Law), 41130 (Emergency Telephone Users Surcharge Law), 43502 (Hazardous Substances Tax Law), 45852 (Integrated Waste Management Fee Law), 46603 (Oil Spill Response, Prevention, and Administration Fees Law), 50153 (Underground Storage Tank Maintenance Fee Law), 55302 (Fee Collection Procedures Law), and 60606 (Diesel Fuel Tax Law).

<sup>2</sup>Article 2.5 (commencing with Section 7076) of Chapter 8 of Part 1 of Division 2 of the Revenue and Taxation Code.

- Have a single or small number of clearly defined taxability issues;
- Agree to participate in the MAP; and
- Have the resources to comply with the managed audit instructions provided by the BOE.

The MAP is advantageous for both taxpayers and the BOE. For example, managed audits:

- Resolve questions about taxability during, rather than after, the audit process;
- Allow the BOE to reallocate audit resources to other audits or other revenue generating activities;
- Reduce the number of protested audits;
- Decrease disruption of taxpayers' regular business activities;
- Promote an ongoing cooperative relationship between taxpayers and the BOE;
- Educate taxpayers regarding how tax applies to their business transactions, which increases accurate reporting; and,
- Offer participating taxpayers a 50% interest "discount" on any tax liability disclosed as a result of the managed audit. MAP audits that result in a credit or refund are computed using the standard running balance method. Therefore, if the audit has both debit and credit periods, the one-half interest rate applies for debit periods while the full statutory credit interest rate applies for credit periods.

Despite its advantages, the MAP is authorized only under the Sales and Use Tax Law; existing law does not provide for a MAP under any of the BOE's special tax and fee programs.

#### **PROPOSED LAW**

This bill extends the MAP authority that exists under the Sales and Use Tax program to the following BOE special tax and fee programs:

- Motor Vehicle Fuel Tax Law
- Use Fuel Tax Law
- Cigarette and Tobacco Products Tax Law
- Alcoholic Beverage Tax Law
- Energy Resources Surcharge Law
- Emergency Telephone Users Surcharge Law
- Hazardous Substances Tax Law
- Integrated Waste Management Fee Law
- Oil Spill Response, Prevention, and Administration Fees Law
- Underground Storage Tank Maintenance Fee Law
- Fee Collection Procedures Law
- Diesel Fuel Tax Law

The bill would become effective on January 1, 2015.

**BACKGROUND**

The original MAP was added to the Sales and Use Tax Law by BOE-sponsored Senate Bill 1104 (Ch. 686, Stats. 1997, effective January 1, 1998) and contained a sunset date of January 1, 2001. In 2000, the BOE sponsored legislation (Assembly Bill (AB) 2898, Ch. 1052) to extend the sunset date of the MAP by two years, to January 1, 2003. The MAP was not reauthorized for 2003. AB 1043 (Ch. 87, Stats. 2003, effective January 1, 2004) reauthorized the BOE to utilize the MAP until January 1, 2009. In 2008, the BOE again sponsored legislation (AB 3079, Ch. 306) that eliminated the January 1, 2009, sunset date, thereby making the MAP permanent under the Sales and Use Tax Law.

**COMMENTS**

- 1. Sponsor and Purpose.** This bill is sponsored by the BOE to add MAP authority to various BOE Special Tax and Fee programs.
- 2. Adds a new audit tool to the special tax and fee programs consistent with the sales and use tax program.** A number of taxpayers are required to hold both a seller's permit and one or more special tax and fee permits. For example, a winery's retail sales are subject to sales tax, and its import of wines is subject to the alcoholic beverage tax. Tire retailers make sales that are subject to sales tax and the California tire fee. Although taxpayers participating in a sales tax managed audit may also wish to participate in a special taxes managed audit, they cannot do so due to lack of statutory authority.

Special tax and fee account holders have transactions that are equally appropriate for a managed audit review. The tax issues related to their business operations are straightforward, and many have the resources necessary to perform the audit work. The following examples illustrate special tax and fee transactions appropriate for a managed audit:

- A distilled spirits taxpayer claims nontaxable sales for resale to other distilled spirits taxpayers. The taxpayer could verify and document that its customers held valid distilled spirits permits with the BOE.
- An electronics retailer that sells computer monitors, laptop computers, and televisions is required to hold a covered electronic waste recycling (eWaste) fee permit in addition to its seller's permit. This retailer could review its claimed exempt sales for resale and sales delivered outside California. The same documentation required to support an exemption from sales tax is also required to support an exemption from the eWaste fee.
- Cigarette and tobacco products distributors who also sell at retail are required to hold a Cigarette and Tobacco Products Retailer's License in addition to a seller's permit. Some of these distributors claim only a few exemptions for which verification is straightforward, such as sales to a common carrier engaged in interstate or foreign passenger service or sales to United States military exchanges, commissaries, or ship stores.

This bill would add a new audit tool to the special tax and fee programs consistent with the sales and use tax program. Eligible taxpayers would receive the same benefits enjoyed by sales tax managed audit participants.

- 3. Advantages for taxpayers.** BOE staff has found that taxpayers who participate in the MAP develop a better understanding of the laws that affect them and are able to report tax liability more accurately.

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In addition, taxpayers who participate in the MAP receive a 50% reduction in the interest due on any unpaid liability discovered during the audit.

**4. Under the current MAP, the BOE may void a MAP Participation Agreement if it determines that:**

- The taxpayer has failed to complete the managed audit by the due date specified in the MAP Participation Agreement.
- The apparent nature or complexity of the taxpayer's operations or transactions require greater levels of review, research, or verification than was originally anticipated.
- The taxpayer has refused to cooperate with BOE staff during the verification process or has refused to cooperate with BOE staff performing the audit work for any transactions specified in the MAP Participation Agreement.
- Any penalties for negligence or fraud are imposed during the audit period.
- The taxpayer has not paid the tax, interest, or penalties due as a result of the managed audit (1) within 30 days of the issuance date of the related Notice of Determination (billing), or (2) as agreed upon in a formal installment payment agreement.

If the MAP Participation Agreement is voided, the taxpayer will not receive the benefit of the reduced interest rate.

**COST ESTIMATE**

Costs associated with the bill are absorbable.

**REVENUE ESTIMATE**

This bill would result in an annual net revenue gain of approximately \$249,207.

This revenue estimate uses historical sales tax MAP data for the period of July 1, 2008, through June 30, 2013:

Average hours saved per sales tax MAP audit	227
Percentage of sales tax MAP audits to total audits	0.0062%
Average interest forgiven per sales tax MAP audits	\$ 60,647 <sup>3</sup>

Estimated Special Taxes Revenue Gain:

Total number of special taxes audits for fiscal year (FY) 2012-13	568
Estimated annual number of special taxes MAP audits	7 <sup>4</sup>
Total revenue derived from special taxes audits (taxes, penalties, and interest)	\$21,579,315
Total number of special taxes audit hours for FY 2012-13	50,921
Tax change per hour for FY 2012-13 (\$21,579,315 / 50,921)	\$424

<sup>3</sup> \$60,647 [\$11,522,858 (total interest forgiven in MAP audits for FY 2008-09 through FY 2012-13) / 190 (total MAP audits completed during FY 2008-09 through FY 2012-13)]

<sup>4</sup> Using the percentage of sales Tax MAP audits to total audits of 0.0062%, the BOE's Special Tax and Fee Department would perform approximately four MAP audits per year. However, based on review of special tax audits, four MAP audits per year appears too low. BOE staff estimates that it will perform a total of seven MAP audits per year.

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Estimated additional audit liability from redirecting audit resources (taxes, penalties, and interest) [227 (average sales tax audit hours saved) x 7 (estimated number of special taxes MAP audits) x \$424 (tax change per hour)]	\$673,736
Estimated special taxes interest forgiven [\$60,647 (average sales tax interest forgiven) x 7 (estimated number of special taxes MAP audits)]	<u>\$424,529</u>
Estimated special taxes net revenue gain (\$673,736 - \$424,529)	<u>\$249,207</u>

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.

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Analysis prepared by:	Debra Waltz	916-324-1890	03/11/14
Contact:	Michele Pielsticker	916-322-2376	
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